

U.S. ECONOMIC POLICY TOWARD CHINA

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**Prepared for presentation to U.S.-Japan Consultative Group on Policy Toward the People's
Republic of China, Asia Society, New York, December 18-19, 1991;
Revised February 7, 1992**

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The Context of Economic Policy

Since the termination of America's and China's policies of isolating themselves from each other, relations between them have been driven in varying degrees by geopolitics, economics, and human rights. Among these three kinds of relations, geopolitics and human rights have been the driving forces and economic policy has been primarily a means to a geopolitical or human rights goal. In fact, there have been two broad phases of economic policy. The quarter century from 1972 to 1989 was marked by gradual expansion of economic intercourse based on shared geopolitical concerns. The period since June 1989 has been characterized by economic conflicts driven primarily by the Congressional response to human rights abuses in China. In both periods, economic policy has been the principal tool employed to pursue political goals. Although the U.S. has had large and genuine grievances about Chinese economic policy, at all times economic policy has been subordinate to strategic or human rights policy. Ironically, conflicts over U.S. economic grievances have exploded at a time when China has been making the world's most successful effort to move from outmoded socialist practices to international, market-oriented policies.

The 1970s opened with preliminary diplomatic contacts, followed by Nixon's visit, limited press contacts, tentative trade, and sparring over the terms of the new relationship. Much of this period overlapped with China's Cultural Revolution (1966-1976), a period of radical excess which directly and indirectly caused the deaths of millions of people. This was a time of extreme privation and extreme repression, when virtually everyone in China wore the same blue clothes, feared contact with foreigners, and offered the same official opinions. China under the Cultural Revolution ranks with Hitler's Germany and Pol Pot's Cambodia among the great human tragedies of the twentieth century. Nonetheless, this was a period when U.S. enthusiasm for China went well beyond geopolitical calculation. The establishment press and the best-regarded academics were single-mindedly enthusiastic about contacts with China and determined to empathize with China (or, more precisely, with the policies of the Chinese Communist government). Books and lectures by Ross Terrill and Orville Schell (who at that time thought the Cultural Revolution a good thing) were popular. The establishment media thought it a cute expression of social solidarity and responsibility when residents of Beijing awoke early to sweep snow off the streets in unison. Trendy New Yorkers had to purchase expensive chinoiserie at Bloomingdales, and the general public became inordinately enamored of panda bears. The decade closed with formal diplomatic recognition, gradual settlement of frozen asset disputes, and the granting of most favored nation status (MFN). Primarily because of the economic benefits proffered to China, the 1970s saw the maximal achievement of U.S. geopolitical goals using the China card. The Soviet Union became outflanked and relatively isolated. At one point Deng Xiaoping characterized China as an honorary member of NATO.

During the 1980s, trade and contacts expanded at an extraordinary rate, spurred by Chinese economic reforms that were approved in late 1978. The world, and especially the U.S., was flooded with Chinese students, diplomats, military representatives, and scholars. As the decade progressed, China itself was transformed by economic growth and by contact with the outside world. Never in human history had so many people benefitted so quickly from rapid economic growth. China was the world's fastest growing economy, and its model of growth delivered the first benefits and the largest benefits to those who needed them most: farm families comprising some 800 million people and light industrial workers comprising the second largest segment of the population.

The impact of economic growth of foreign contacts on the freedom of information, opinions, and personal choices available in China was particularly dramatic. By 1981 a few people dared to dress small children in vivid colors while sticking to politically correct blue for themselves; by 1991 most people dressed in colorful, Western-style clothing. Contact with the outside world had an impact, first on Chinese travellers abroad, then later on Chinese society itself, far greater than anyone had predicted. A few weeks of exposure to the West turned out to be adequate to change the thinking of most students and scholars, and a few months typically had a similar effect even on life-long diplomats and hardened military officers. Chinese became more outspoken in their comments about society and politics. During this period Chinese society was permanently transformed. Although the instruments of totalitarianism remained, they were no longer fully effective.

Ironically, the 1980s were the period when political opinion in America became skeptical about China. On the right, Reagan's 1980 campaign advocacy of upgrading U.S. ties to Taiwan revitalized Taiwan as a central problem in U.S.-Chinese relations until, ironically, the Reagan administration agreed to ceilings on sales of military technology to Taiwan that were stricter than any of its predecessors had contemplated. Under the leadership of Secretary of Defense Weinberger, the U.S. tightened controls on technology transfers to China to an extreme.¹ On the left, Fox Butterfield of the *New York Times* and Richard Bernstein of *Time* published books highly critical of China. Butterfield's *China: Alive in the Bitter Sea* achieved popularity and widespread influence just as the benefits of Deng Xiaoping's reforms began to be widely felt in China. This shift in American attitudes caused a decisive shift in Chinese policy; just as the Reagan administration was putting geopolitical competition with the Soviet Union as the highest national priority, China changed from being an "honorary member of NATO" to an "independent foreign policy" whose posture

¹On a late 1981 trip around China, I was repeatedly questioned by PLA officers about why the U.S. had completely banned all sales of technology that they were interested in. They made it clear that this was having an impact on political relations. In August 1985, when I moved to Hong Kong, I wanted to take my IBM XT computer with me, but it turned out that the approval process was so difficult that the time required to obtain permission was worth a multiple of the value of the computer. Such were the constraints on export of a computer to friendly Hong Kong, which has controls on sale of technology to China that have recently been certified as COCOM-acceptable. At that time, knockoffs of much more powerful IBM AT computers were being made in China and exported to Hong Kong in large quantities. About that time, U.S. policy began to shift again, and the U.S. began to sell some sophisticated weapon systems.

toward the two superpowers was "a plague on both your houses," although it was somewhat more favorable to the U.S. than to the U.S.S.R. In this period, because of obsolete perceptions on both the right and the left, some of the geopolitical gains of the previous decade were lost, but at little cost to the U.S. since the Soviet economy was rapidly weakening.

Since June 1989, the government has attempted to suppress dissent, but the economic and social revolution in China has continued. China has emerged from the cyclical counter-inflation squeeze of 1989 into a period of renewed growth at the 7 percent rate typical of the Pacific Asian miracle countries, and it has done so during a time of U.S. recession and global slowdown. Economic reform has made great progress. Price reform has advanced decisively. A majority of foreign exchange transactions take place in the free market and the rest at near-market rates. Wholly owned foreign investments are encouraged on terms more far more favorable than those provided by such free market allies as the Philippines and Indonesia. China is blossoming with bond markets, stock markets (three official ones, many informal ones), and futures markets (seven opened since October 1990, with the help of the Chicago Board of Trade).² China is opening its stock markets to foreigners considerably faster than Taiwan and South Korea. China's state enterprise sector is down to less than half of GNP and is continuing to decline sharply. The foreign-invested sector, already a substantial proportion of total industrial production and exports, is growing at ten times the rate of the state enterprises and the independent sector is growing six times faster than the state enterprises. The share of foreign trade in China's economy is larger than Japan's and twice that of the U.S.

Rapidly rising standards of living liberated several hundred million people from a degree of poverty that had hitherto made their lives almost subhuman. As the lifestyle of the average coastal and urban Chinese has been transformed from near-subsistence to poor-but-unmistakably modern, the range of personal choice and expressible personal opinion has expanded. Workers in the major cities wear T-shirts of the latest fashion; the T-shirts of young people often bear quirky slogans that attract ineffectual government efforts at suppression. Peasant women in the rice fields of Hunan wear permanent hair-dos. In Guangdong, the only concession to tradition at the fashion shows put on by the Victoria's Secret lingerie factory is that the models come from Hong Kong. So many Chinese travel abroad that information available outside China circulates rapidly inside it. Radios that can listen to the outside world are widely distributed. *The Asian Wall Street Journal*, perhaps the most outspokenly anti-Chinese government of the world's major newspapers, is available in

²On the role of capital markets in China, cf. William H. Overholt, "The Emergence of Chinese Capital Markets," *Asian Survey*, May 1991. The stock and futures markets are still in their infancy but are likely to grow rapidly because China's leadership sees them as playing a central role in mobilizing China's savings for productive use (the stock markets) and in sending market price signals for those commodities whose prices are still state-managed (the futures markets).

all major cities, and CNN is available in the major hotels.³ Travel restrictions have loosened, sometimes officially, sometimes unofficially, and a substantial portion of the population has money for modest travel, so people and ideas circulate quickly. Most important of all, people feel free to speak their minds on most subjects despite a repressive official policy.

China's desire for technological progress led to some relaxation of political controls at universities and research centers, and its desire for economic efficiency led to relaxation of political controls in places of work. Vast flows of Chinese officials, military officers, businessmen, intellectuals and students overseas created direct contact with different systems and different ideas; the impact on their thinking proved to be revolutionary. This impact was rendered broader and deeper by floods of visitors to China from the West, from non-communist Asia, and eventually even millions of visitors from Taiwan. Within China, fierce debates over policy became relatively open and transparent to the general public. Foreign ventures created a class of jobs that were not under the control of Party political operatives, and Chinese firms in places like Hong Kong liberated tens of thousands of people almost completely from political control. Whereas in 1981 criticism of the government was rare, by 1991 it was commonplace.

In short, by the late 1980s the structure of Chinese society had changed in ways that increased the dignity of the average person, increased his or her range of choices of opinion and action, and enhanced freedom of movement and of speech. China had changed from a truly totalitarian society to one that was still a very repressive dictatorship but was losing its totalitarian character. That is to say, it was changing from one more like North Korea to one more like South Korea during South Korea's more repressive periods--a huge improvement even though it was from a very low base. This occurred not primarily because the government or Party had decided that it wanted to allow people to criticize the government or to move from Hunan to Guangdong but rather from changes in Chinese society created by the drive for economic growth. This distinction is central to any discussion of human rights policy in China.

On the most sensitive subject of all, namely attitude toward China's leadership, there is little reticence. The guides of China Travel Service, in principle well-trained propagandists, tell you how much they hate the old men of Beijing. Government officials in Beijing tell the casual visitor that everyone recognizes the importance of getting rid of Li Peng but that it is important to do so peacefully. Even U.S. military officers are startled to hear hosts, Chinese officers carefully picked from the most politically correct units and long-term Communist families, express similar sentiments. The only conclusion one can draw from this

³One has to buy the *Asian Wall Street Journal* with Foreign Exchange Certificates, but these are freely available and no longer cost significantly more than regular currency. CNN is available only in the Foreign Ministry and in major hotels, but it is common practice during major events such as the Gulf War for Chinese citizens to reserve a hotel room so they can watch CNN. This exposes only a tiny elite to such sources, but those who have the education and language skills to benefit do have access, and from them exciting ideas and information reach a remarkably wide audience.

is startling to those who have not visited China recently: life for most Chinese people is getting freer at a remarkable rate--despite government policy to the contrary. Thus the open economy, facilitated by the U.S. policy of making its market available, has inadvertently accelerated the demise of totalitarianism and the emergence of a significant although still severely limited degree of personal freedom.

None of this is due to government policy. Especially since June 1989, the government has been using all the old tools--indoctrination, spying, arrests of dissident leaders, isolation of Chinese students from foreign students, propaganda campaigns, and many more--to suppress "peaceful evolution," which is the ultimate nemesis of this generation of totalitarian-minded leaders. The problem of the government is that the old tools simply don't work anymore. There are too many sources of information for the government to be able to impose monolithic views. There are too many people of rank in the party, the army, and the government with "wrong" views for the leadership to be able to root them out; much of the second, third, and fourth rank leadership has seen a more relaxed future and believes that it will work. There are too many dissidents and outspoken academics and artists with access to the foreign press for the government to be able to arrest them all. The prosperous coastal provinces can confront conservative leadership on some issues (e.g., taxes at the end of 1990) and flatly refuse to accept central policy; they can absorb and convert (and sometimes bribe) most of the officials Beijing sends out to improve discipline on other issues. Through no intention of the gerontocrats, China has changed irrevocably. It is no longer a totalitarian system. The vicissitudes of economic growth have changed it into a fast-growing, reluctantly liberalizing authoritarian society roughly on the model of South Korea in the early 1970s.

Since 1989, American policy and attitudes have changed, too. The skepticism of the early 1980s gave way in the months before Tiananmen Square to a euphoric belief that China was headed toward early capitalism and democracy, followed by disillusionment and revulsion after June 4, 1989. Since the Tiananmen Square massacre, the dominant American view of China has been that the policy of its leadership is brutally repressive (completely true), economically reactionary (completely false), and internationally irresponsible (true in key details, false in overall thrust). With the collapse of Soviet communism, much of Washington opinion believes that geopolitical concerns are no longer important, so American policy, including economic policy, no longer need, in this view, be structured to foster continued rapprochement with China. Television images of the Tiananmen Square massacre have convinced much of Congress that American policy must in the future be driven by human rights concerns and that the most efficacious way to implement human rights policy is to impose, or threaten to impose, economic sanctions on a scale that would cripple the coastal export-oriented sectors of the Chinese economy.

This brief sketch of U.S. relations with China the past two decades emphasizes several points. First, American economic policy has been subordinate to political policy. Second, the opinions of America's cultural elite have continued to be as erratic in the present as our history books tell us they have been in the past: infatuated during the Cultural Revolution,

mildly negative just when trends in China most closely coincided with U.S. strategic, human rights, and economic interests; and urging economic warfare in order to implement a human rights policy just when the social consequences of economic progress were liberating the Chinese people from totalitarian oppression. Third, in the 1970s U.S. geopolitical calculations, economic interests, and erratic cultural perceptions converged in a way that redounded strongly to the benefit of both China and the U.S. Fourth, in the 1980s, geopolitical interests, human rights progress, and mutual economic benefits were achieved to a degree that was not anticipated despite adverse shifts in erratic cultural perceptions.

Given this broad context, we can review the detailed interaction between economic policy and the broader American-Chinese relationship and assess whether the serendipitous interaction among human rights, geopolitics, and economics can continue.

The 1970s and 1980s: Geopolitics and Economic Policy

U.S. policy in the 1970s was dominated by geopolitical concerns: playing the China card against an expansionist Soviet Union which both Washington and Beijing perceived as threatening vital national security interests, and using China as an intermediary to extract the U.S. from the Vietnam War. Few U.S. economic interests appeared to be engaged in autarkic, impoverished Cultural Revolution China. Human rights concerns were minimal or rationalized away: conservatives focused on Realpolitik rather than human rights, liberals believed that Mao's government had broad popular support and that the Chinese people did not care about Western human rights, and radicals believed that Mao had articulated a new and better way to organize human society that rendered old Western concepts of human rights obsolete. From 1972 to 1978, Chinese policy was the mirror image, focused largely on national security.

Although economics was not the focal point of either party's concern, normalization of economic relations became an important tool for cementing the political relationship and a central symbol of the status of the political relationship. The unfreezing of frozen assets, the normalization of relations between American and Chinese banks, the gradual permission for sales of various kinds of technology to China, the granting of Most Favored Nation Status to China but not to the Soviet Union, and the oscillating debate over military sales to China defined the state of relations, and fine-tuned that relationship, much more precisely than the three pivotal political events of the decade: the Nixon trip to Beijing in 1972, the admission of China to the United Nations, and the normalization of diplomatic relations in 1979.

From 1978 onward, economic relations moved to the center of policy on the Chinese side. Deng Xiaoping made a conscious and clearly articulated decision to give economic development priority over politics and ideology. In domestic policy this momentous upending of Maoist priorities was expressed in the slogan that it didn't matter whether a cat was black or white, only whether it could catch mice, and the associated shift toward a more

market-oriented economy. In international relations, this priority led to gradual but systematic disengagement from international conflicts that diverted resources from economic development, to a politically risky economic opening of Chinese society, and to a striking curtailment of military expenditure.

The result, achieved gradually over the 1980s, went beyond anything Nixon or Kissinger could have imagined. China changed from an actively disruptive international actor to a constructive one. Prior to 1972, China believed that international disorder served its interests; was actively subverting the governments of many countries in Southeast Asia and elsewhere; had such a hostile relationship with the Soviet Union that military clashes had occurred and the Soviet Union had been tempted into preemptive nuclear strikes; maintained a hostile relationship with Japan; sided automatically with an aggressive North Korea; was aggressively hostile toward Taiwan; and automatically voted against the United States on any United Nations resolution pitting the U.S. against a radical third world country.

In contrast, China subsequently made peace with all its neighbors. It became a force for peace between North and South Korea. It dealt constructively with all governments in non-communist Southeast Asia and curtailed all support for communist insurgencies there. It replaced tense diplomacy and threats over Taiwan with a major rapprochement that culminated in huge flows of trade, investment, and tourism from Taiwan. It moderated its formerly hostile policy toward Japan and achieved rapprochement with the Soviet Union. It reduced military expenditure to under 2% of GNP, the lowest of any significant country except Japan.

Economically, China has joined the world system to a greater degree than any other communist or formerly communist country. To judge a country's participation in the international trade system, we can measure its trade as a share of GNP. For 1989, economically China's worst year of recent times, the Soviet Union's trade was 5.4 percent of GNP, Brazil's 16 percent, the U.S. 16.4 percent, Japan 27 percent, and China 26.1 percent. In 1990, China's trade rose to 32.4 percent of GNP.⁴ While there are serious statistical problems in comparing developing and developed nations with this measure, no statistical adjustments can belie the fact that China has emerged from autarky to become a full participant in international trade. It has not reverted to pre-1989 practices and indeed has made its most rapid advances in the period since 1989.

4. The 1989 data for China, Brazil, the U.S. and Japan are from IMF, *International Financial Statistics* (1990 Yearbook). Data for Soviet trade are from IMF, *Direction of Trade Statistics* (1990 Yearbook) and for Soviet GNP a CIA study which gives Soviet GNP as \$2.5 trillion. 1990 China figures are from the U.S. Consulate in Hong Kong (exports \$61 billion; imports \$59 billion; GNP 1772 billion yuan, which at an exchange rate of 4.7832 equals \$370.46 billion). The latter exchange rate is the average 1990 exchange rate as specified in *International Financial Statistics* (March 1991).

In short, China became a conservative, constructive force in world politics and the world economy to an extent that the greatest optimists of the early 1970s, liberal or conservative, could not have imagined. As with South Korea, Taiwan, Singapore, and Thailand, it was access to the U.S. market that made this policy succeed economically for China. While the direct alignment of China and the U.S. diminished in the 1980s as compared with the late 1970s, both politically and in cultural attitudes, the relationship served U.S. interests as never before.

As well as becoming a constructive force in global politics and economics, China became unexpectedly an object of considerable economic interest in this period. As noted above, U.S. strategy was premised on the implicit assumption that economic relations were purely a means to a geopolitical end. The emergence of a China with more than \$100 billion of trade and with more open investment rules than most U.S. allies in Asia was an unanticipated side benefit.

During this period, the missing issue was human rights. The Chinese government was not concerned to develop human rights even though substantial changes in the country's human rights situation did occur during the 1980s. Although the U.S. applauded when the government loosened up political controls, concern for human rights did not modify any significant geopolitical, economic, or diplomatic relationship during the period from 1972 to 1989. But during this period the most profound positive changes in more than a century occurred in the dignity and freedom of the Chinese people. This occurred not because of direct policy decisions about human rights but because of social structural changes that occurred.

American policy during this period had aimed at narrowly geopolitical goals, using economics almost exclusively as a political lever, and had serendipitously achieved geopolitical, economic, and human rights improvements to an extent that had not been imagined possible when the policy was initiated.

Split Policy: The Centrality of Human Rights Since June 1989

Immediately prior to Tiananmen Square there was burst of Western euphoria over Chinese politics as a combination of economic and political liberalization led to widespread expectations of the early emergence of capitalism and democracy in China. This euphoria occurred despite the frequently reiterated statements by a firmly entrenched Chinese leadership that it would adhere to the Four Principles that enshrined socialist economics and Communist Party dictatorship. This euphoria was brought to a peak by the unprecedented willingness of a communist leadership to allow the huge protest movement in Tiananmen Square and to allow it to be televised. The ensuing televised bloody massacre engraved a seemingly permanent image of China as a barbaric country. This sequence of unwarranted

euphoria and bloody repression naturally brought human rights concerns to primacy, and the simultaneous collapse of the Soviet Union devalued geopolitical issues.

Since that time, U.S. policy toward China has been split between an executive branch determined to retain a geopolitical relationship with China and a Congress largely determined to press human rights concerns as the sole priority. Economic policy remains the primary tool of policy, and therefore has become an arena of bitter political struggle.

That economic policy is still primarily an end rather than a means is easy to ascertain. First, Congressional hearings in 1991 focused on human rights issues almost to the exclusion of economic issues, even for the panels of witnesses composed primarily of economic interest groups. Second, Secretary of State Baker's November 1991 trip to Beijing focused primarily on human rights rather than economic or strategic issues. Third, the center of gravity of business opinion is that the U.S. government is endangering the entire economic relationship for political reasons and should moderate its approach. While every segment of the U.S. business community has some direct experience of unfair Chinese trade practices, and while many actively seek the assistance of the USTR, there is substantial bitterness among many businessmen who are successfully doing business with China over what is perceived to be the hamhandedness and politicization of U.S. trade policy. This is the opposite of the opinions of the same groups in dealing with Japan, where the center of gravity favors much stronger government intervention.⁵ If economic issues were paramount, then business opinion would be given great weight, but it is not. Fourth, the thrust of press commentary is clear: economic grievances are primarily cited as support for those who believe in economic retaliation for human rights abuses.

While economic issues remain primarily a means to political ends, by late 1991 they attained real importance of their own and some degree of autonomy because trade policy is implemented by a separate bureaucracy with its own agenda. The emergence of a Chinese trade surplus with the U.S. on the order of \$10 billion per year has engaged the full attention of the office of the U.S. Trade Representative (USTR). Since the Chinese deficit has ballooned at a time when the U.S. economy is fragile and the U.S. trade deficit large, the context has been very different from the earlier decades when the Japanese, Korean, and Taiwanese deficits first emerged.⁶

The engagement of a powerful bureaucracy that really does care about economic issues and really does want to solve them creates a third phase of U.S. economic policy toward China.

⁵USTR contacts with the business community tend to obscure this. USTR procedures focus on discontented groups demanding intervention and disregard or devalue the opinions of groups that are conducting successful business.

⁶By 1990-'91 the U.S. trade deficit was down sharply from earlier years, and the real U.S. problem was its domestic budget deficit, which was much larger and expanding fast. But a weak U.S. economy always stimulates concern about employment, and concern about employment focuses easily, albeit shortsightedly, on foreign competition.

This phase is complicated by a further development: the full-scale emergence of a trade lobby seeking to use human rights as a cover for protectionism. Washington-based China specialists report a lucrative wave of efforts by lobbyists to use allegations of prison labor exports and other human rights abuses to curtail competition from China. A prominent example was an effort by an affiliate of the AFL-CIO to organize a Christmas 1991 "Toycott" of certain toys (e.g., Teenage Mutant Ninja Turtles) from China based on allegations that they were produced by child labor. The toycott collapsed when it became immediately clear that there was no evidence for the allegation and that the organizers had made no attempt to gather evidence.

Although this mobilization of economic issues for their own sake was an important new development, it occurred within a framework established by Congressional human rights concerns. The White House unleashed the full wrath of USTR as part of a strategy to deflect pressures away from China's Most Favored Nation status. The USTR's unusually aggressive and unyielding posture derived from the necessity to prove to Congress that it really was beating up on China. Likewise, the protectionist lobby had much better prospects, and was able to get away with tactics that would otherwise have been unacceptable, because it could leverage and hide behind the human rights agenda.

In short, the trade issues with China were large enough that a conflict would have arisen under any circumstances--and justifiably so. But if China had been Thailand, and had made the concessions China made during 1991, then the negotiations would have been wrapped up quickly. And if China made the maximum trade concessions imaginable, there would still be Congressional human rights pressures to impose economic sanctions.

Human Rights Advocates' Move To Abolish MFN

The initial thrust of Congressional desire for sanctions against human rights abuses took the form of demands that China be denied Most Favored Nation (MFN) status. In the House of Representatives, where sentiment against MFN is strongest, the initiative has been led by Rep. Nancy Pelosi, whose interest is focused almost entirely on human rights issues. Although her original draft bill also addressed economic and security issues, she and many of her colleagues were party to an effort led by Rep. Stephen Solarz in the early summer of 1991 to condition MFN entirely on human rights concerns. This effort succeeded in the House, but initially failed to obtain a Senate majority large enough to override an expected presidential veto--due to concern that it could prove counterproductive by hurting Chinese liberals and helping the conservatives.

MFN and the Politics of Reform in China. Depriving China of MFN would be intended primarily to promote human rights in China by punishing the Chinese government. But China is not homogeneous, and MFN deprivation will grievously damage those parts of China that have done the most for their people while helping those who oppose further economic and political liberalization.

The core of China's export economy is several coastal provinces, most notably Guangdong Province adjacent to Hong Kong, Fujian opposite Taiwan, the Tianjin-Shandong area, and the Shanghai area. Guangdong has a population and territory the size of France. Its people speak mainly Cantonese, whereas Beijing's language is Mandarin; when they can get away with it, local Guangdong officials often pretend to visitors from Beijing that they cannot speak Mandarin. Workers in Guangdong earn 60 percent more than China's average -- a difference that makes them inhabitants of a different world from the people of the interior.⁷ In Guangdong, as in the other high-growth coastal provinces, there is far greater freedom of speech and movement; people watch Hong Kong television and listen to Hong Kong radio. Large numbers of people move to and from Hong Kong, and communicate to their province-mates the reality of life outside China. As in the other fast-growing coastal provinces, there was no loss of life at the time of Tiananmen Square. The coastal provinces introduce innovations such as stock markets long before Beijing has approved them. The leaders of these provinces have been relatively moderate in dealing with dissent, relatively relaxed in dealing with rapid social change, and encouraging of further economic liberalization.

So great are the differences between conservative Beijing and the relatively liberal coastal areas that papers sponsored by the Joint Economic Committee of the U.S. Congress have spoken of "Two Chinas." So intense is the competition between the exponents of the two approaches that testimony to the same committee has warned of the danger of "structural immobilization."⁸ Beijing is fearful of the coastal provinces' increasing autonomy and determined to get them back under firmer control through political and tax and regulatory measures. In response, the coastal provinces have mobilized local political support, rebuffed Beijing's efforts to impose far higher taxes, and insisted that their path is the only path to save China's future. The result has been a broad division between coastal liberals, with broad sympathy from the younger population and other reformist groups of the interior, and the old-line conservatives of Beijing.

The old-line conservatives are in trouble. After the Cultural Revolution and the Tiananmen Square repression, ideological appeals no longer mobilize much support. They must therefore fall back on pocketbook issues. But, with a worsening drain from state enterprise deficits, the only way they can put more money in people's pockets is through liberal

⁷ Workers' 1988 annual per capita income in Guangdong was 1600 yuan compared with 1024 for China's overall average. Source: State Statistical Bureau, "China's Social Statistics--1990."

⁸ Joint Economic Committee, Congress of the United States, "China's Economic Dilemmas in the 1990s: The Problems of Reforms, Modernization, and Interdependence," Volume I, pp. 13, 16. I do not mean to suggest that all of China's reformers are on the coast or that all important officials in Beijing are conservative. But a reformist society has been created along the coast with two characteristics: Structural changes caused by economic development make life freer and better than in the interior regardless of official policy. And reformist success has reached a critical mass that would require massive force to reverse.

reforms. As Premier Li Peng's last major review of the economy made clear, the conservatives have no theory of economic victory. Piecemeal and rapid, but inadequate, acceptance by the conservatives of liberal reforms in the last six months underlines the conservatives' plight.

Conversely, the reformists' appeal is broad and getting broader. They are delivering higher living standards, they have delivered some of the highest rates of growth in world history, and they have spread the benefits around so as to create a broad base of support for further reform. The recent elevations of Shanghai Mayor Zhu Rongji and State Council Commission Chairman Zou Jiahua⁹, along with many lesser appointments, indicate that the reformers are making political inroads. They have credible solutions to the major problems of liberalizing a socialist economy: use bond markets and fiscal austerity to control money supply and thereby limit the inflationary impact of price liberalization; subsequently use stock markets to raise money and partially privatize loss-making state enterprises; and liberalize the economy gradually to avoid the hideous social disruptions of the precipitous Polish strategy. While the leading conservatives have acquiesced in much of this approach, these measures will ultimately destroy the tight economic, social and political control which is the essence of the conservatives' political program.

In the struggle between the old-line conservatives of Beijing on one hand and the youth and coastal reformists on the other, depriving China of MFN status would cripple the liberals. It would devastate the economies of the reformist coastal provinces, weakening their political base and exposing them to the accusation that their policies make China vulnerable to foreign manipulation.

Some supporters of MFN deprivation believe that these sanctions would bring Beijing's conservatives to their knees. If so, temporary damage to the reformists might be justified. But Beijing is insulated by some of the world's largest foreign exchange reserves (projected by the conservative Institute of International Finance at \$44.5 billion of foreign exchange and gold for end-1991) and one of the third world's lowest debt service ratios. For all its problems, China's economy is more financially and economically resilient than most Third World economies. Moreover, deprivation of MFN will fail to bring Beijing to its knees because it will have almost no support from America's allies and friends. Japan, Europe, and Southeast Asia have all greatly improved political and especially economic ties with China in the past year, and those trends will continue.

For China's ultra-conservatives, deprivation of MFN status would provide the only available opportunity to argue that the liberals' case is even weaker than their own. More important, it would deliver to the ultra-conservatives the only persuasive argument against further liberalization, namely that further opening of China's economy and polity will make China once again vulnerable to the foreign intervention that humiliated China repeatedly during

⁹Zou Jiahua is often characterized in the Western press as an economic conservative. This is incorrect.

two centuries prior to 1949. There is no more powerful or persuasive argument in Chinese politics; it is one of the central reasons why the communists attained power in China in the first place.

There is ample precedent in China for well-meaning liberals to entrench the conservatives in power. Former Communist Party Secretary General Hu Yaobang fell when liberal political movements prematurely challenged the right of the establishment to rule. The current repressive conservatism in Beijing achieved power only because the gathering of a million dissident students in Tiananmen Square gave conservatives an argument that the stability of China was endangered. Liberal General Secretary Zhao Ziyang cried openly when the students refused to disperse, presumably because he understood what the consequences would be. Deprivation of MFN would hand the conservatives an equally potent argument that further liberalization will put Chinese sovereignty at risk.

Advocates of MFN deprivation present themselves as the strongest opponents of China's repressive conservatives. But the anti-MFN bills give China's ultra-conservatives the only issue that could sustain them in power and offers the return to isolation that some of them seek but cannot advocate openly.

The Special Character of MFN Deprivation. Depriving a nation of MFN status is no ordinary sanction. Most sanctions take for granted that a country is a member of the world economic and political system and, in that context, send a message that we believe the country is not obeying all the rules of that system and will face specific penalties until it complies. Controls on military sales, controls on high technology sales, Section 301 penalties, Special 301 penalties, bans on high level contact, Voice of America broadcasts, and such acts as President Bush's meeting with the Dalai Lama, all are targeted sanctions intended to induce action on specific points of grievance without challenging the country's membership in the global system.

In contrast, depriving a nation of MFN status expels it from the system. "Most Favored Nation" is a misnomer in that it suggests some special favor. On the contrary, it merely signifies non-discriminatory treatment and is a status held by almost every significant country. Denial of this status is confined to only nine of the worst enemies of the United States (out of over 160 countries and territories).¹⁰ The U.S. does not expel Japan from the system even for very large trade deficits and very serious trade barriers. It does not eject Thailand, Malaysia, and Indonesia for much more extensive violations of intellectual property rights than China's, nor has it even denied Iraq or Burma Most Favored Nation status.

¹⁰ Countries now denied MFN status are Afghanistan, Albania, Cambodia, Cuba, Laos, Mongolia, Romania, the USSR, and Vietnam. Source: U.S. Consulate in Hong Kong, citing an official document dated May 15, 1991.

Hong Kong firms with production in China are among the world's greatest exporters of toys and apparel. Without MFN status, the tariffs on the most important categories of toys would rise from 6.8 percent to 70 percent. The tariffs on most categories of apparel rise to 90 percent. These numbers constitute expulsion from the system.

Depriving China of Most Favored Nation status would have the following consequences. On the positive side, it would allow us to express our frustrations with China in a very dramatic manner. On the negative side: It would devastate China's liberal reformists by depriving them of their economic base. It would strengthen China's repressive conservatives by providing them with a national security justification for their policies. It would enhance Chinese military spending, the political role of the Chinese military, and Sino-Soviet military cooperation. It would worsen the livelihoods of millions of impoverished people. It would devastate Hong Kong, the principal outpost of Western-style liberty and free trade in Asia, and would do significant damage to Taiwan. By damaging Hong Kong, it would constitute a major affront to Britain, recently our strongest wartime ally, and would put us at odds with the policy of virtually every one of our allies. It would endanger Chinese-American cooperation over Korea, Taiwan, Southeast Asia, United Nations votes on Iraq, and a vast array of the most vital international issues. It would damage American competitiveness in the world's most dynamic markets.

Geopolitical Aspects of MFN. The view of the Congressional human rights advocates is that, following the collapse of Soviet communism, the U.S. no longer needs a relationship with China, that China is a rogue regime exporting missiles to the Middle East and nuclear technology to North Korea and the Middle East, that there is no other human rights weapon with the clout of MFN, and that their goal is not to deprive China of MFN, which might indeed have the counterproductive consequences noted above, but rather to frighten China into liberalizing and thereby retaining MFN.

The Geopoliticians Focus on Specific Issues

Those who are concerned about maintaining a relationship with China have responded by arguing that, while the U.S. has serious problems with China, MFN is not the right weapon. This view argues that: the U.S.-China relationship remains strategically important; there are other weapons that can achieve trade, strategic and human rights goals without destroying the relationship; and that legislating the MFN weapon is too dangerous because one might then be forced to use it, causing a collapse of the cooperative relationship that could have consequences for a generation. Finally, this view argues that MFN deprivation will be counterproductive in promoting human rights and therefore one must use other weapons.

Soviet Collapse and U.S. Geopolitical Interests. The collapse of Soviet communism and its associated regimes certainly does reduce the threat to the industrial democracies and therefore makes alliances with China and other nations less urgent for the moment. But the increase of international stability from China's overwhelming priority for economics remains valuable. It would not serve U.S. interests if China reverted to a policy of hostility toward

Japan, subversion of ASEAN governments it doesn't like, strong support of ideological orthodoxy in the regimes of the former Soviet Union, support of North Korea, and antagonism toward Taiwan. The world needs Chinese collaboration in maintaining peace in Korea at a time when the Northern regime may be on the verge of collapse but also on the verge of acquiring nuclear weapons. As many big power wars have started in Korea during the past century as have started around Germany. To believe that solution of the postwar problem of Europe/Germany ensures world peace is at best an ethnocentric Western perspective. The U.S. needs Chinese collaboration in building a stable order in the Pacific at a time when U.S. financial and military resources are dwindling and future relationships among Japan, China, and the former Soviet Union could either contribute to a peaceful world or become the fragmentation lines of future world conflict. The U.S. cannot afford to risk a future situation in which the most dynamic nations of the world, namely Japan, China, and possibly other Asian nations, are simultaneously alienated from it. World peace would not be served by a situation in which the chaos in Eastern Europe and the former Soviet Union was exacerbated by a similar situation in China and possibly India. The U.S. needs Chinese cooperation or acquiescence in the United Nations on issues like Iraq's invasion of Kuwait.

Today this sounds very theoretical--as a warning during the last months of Hitler's collapse that there was a risk of future conflict with the Soviet Union would have sounded theoretical. War in Korea sounds like a very distant risk to most Americans--just as the risk of a lesser war in the Middle East seemed before August 1990. The need for Washington to be able to function as an honest broker among China, Japan, and the Russia appears abstract. But the risk of building a conflictful rather than cooperative world is very real. A U.S. policy that severely damages the Chinese economic miracle just at a time when hundreds of millions of Chinese had become conscious of the enormous benefits of that miracle entails the risk that once again an entire generation of Chinese would perceive the U.S. as hostile to their interests.

China has not in fact been behaving as a rogue regime. With regard to all the above issues, China remains a constructive force. China's nuclear and missile sales to Middle Eastern countries are an important issue, particularly in the wake of the Gulf War. But they are in fact less dangerous to the non-proliferation regime and to the risks of conventional war in the Middle East than France's determination in the 1970s to sell reprocessing plants to countries like South Korea and Pakistan and to maximize revenues from Middle East arms sales. China's abstention on the crucial U.N. vote that enabled the U.S. to proceed against Saddam Hussein shows how China remains willing to completely subordinate its traditional foreign policy principles (in this case, of always opposing any Western attack on a third world country) to the need for a workable economic relationship with the U.S.¹¹ Since

¹¹Shortly before the U.N. vote, a high-ranking Chinese official made a point of telling this writer that facilitating a U.S. attack on Iraq remained contrary to many of China's most cherished principles. However, he said, the overriding principle was to support China's development by maintaining peace on all of China's borders and maintaining access to international capital markets. China would abstain, thereby supporting the U.S., in

Secretary Baker's late-1991 trip to Beijing, China has stated its willingness to discuss cooperating with the missile control regime and to refrain from assisting North Korea's nuclear weapon program.

The Easy Cases. In accordance with this view, the Bush administration has sought to employ targeted sanctions to deal with human rights abuses, destabilizing military sales, and trade disputes. Some of these sanctions are relatively uncontroversial. Under American law, and under a consensus of American public opinion, prison labor exports are not acceptable to the United States and will be banned; they are extremely limited in volume, but the principle is important. (The Chinese government has promised to enforce a ban on such exports.) Likewise, Chinese mis-labelling of the country of origin or the contents of a cargo is not acceptable and presumably will be stopped whenever detected; these practices are very widespread, sometimes with the connivance of the central government, sometimes not.

Economic Sanctions and Strategic Issues. Chinese sales of missiles, nuclear equipment that might promote proliferation, and high technology conventional weapons in certain situations (most notably in the Middle East) are a matter of U.S.-Chinese dispute.¹² The Chinese military has a particular incentive to sell military technology because China's military budget has been cut down so drastically. Moreover, the central government often exercises very limited scrutiny over foreign sales by the major military firms; for instance the Foreign Ministry is not consulted on such things as jet fighter sales to the Burmese military. In such disputes, targeted economic sanctions, including either trade sanctions or bans on technology transfers to China can provide the U.S. with leverage. The sanction is appropriate because it targets the specific problem rather than the overall relationship and can precisely offset any advantage the Chinese military or government would obtain from the military exports.

After Chinese sales of certain missiles to the Middle East were confirmed, the U.S. banned the sale of certain dual-use technologies, including the guidance systems of some Boeing civilian passenger aircraft the Chinese would like to purchase. Moreover, the U.S. is unlikely to restore such sales until China accepts a very broad package of adherence to the

order to maintain access to international capital markets. Notwithstanding harsh comments made by both sides during the war, Chinese officials believed they had done Washington an enormous service and would be repaid when economic issues were raised. The refusal to take this into consideration, as alliance was taken into consideration in U.S. trade dealings with Japan, South Korea, Thailand, and other allies, appears to the Chinese as a betrayal. This is an outstanding case of two leaderships talking past each other.

¹²There has been a tendency to moralize these disputes. Except in the case of non-proliferation, moralizing is inappropriate. The Missile Control Regime was set up without Chinese involvement and specifically tailored to Western missiles. The most bitter U.S. complaints about Chinese breach of the ban on missile sales to Iran occurred while the U.S. was secretly selling missiles to Iran. But, putting aside the moralizing, the Chinese have been quite insensitive about missile sales to the Middle East and South Asia, and the U.S. certainly has every right to assert its interests in the Middle East peace process by limiting the technologies it will sell to any country that makes the peace negotiations more difficult or warfare more dangerous.

Non-Proliferation Treaty, adherence to the Missile Technology Control Regime, and possibly others. These restrictions are matters of consensus in Washington; the geopoliticians feel even more strongly about them than the human rights advocates, and there is no opposition from any segment of the political spectrum. China has expressed willingness in principle to cooperate with NPT and MTRC rules, but has not yet signed a detailed agreement with the U.S. In February 1992, China proffered a written guarantee regarding missile sales.

Controls on Military, Crowd Control and Law Enforcement Technology as Human Rights Sanctions. In a context of human rights abuses, the imposition of controls on exports that would facilitate further such abuses is a targeted and appropriate, albeit limited, sanction. Since Tiananmen Square, the U.S. has abrogated agreements with the Chinese on military cooperation and forbidden sales of weapons and COCOM-restricted technology. It has stopped delivery of TOW missiles China had contracted for, stopped military training for the Chinese, and removed from some advanced aircraft avionics that China had purchased.

One caveat to the use of technology and other sanctions on the military is a requirement to keep in mind the larger context: The Chinese military has acquiesced in economic reform, including severe cuts in military budgets, because it came to believe that the country's security could only be improved by upgrading the technological level of both the country and the army. Because of this motivation, the Chinese Army has been a positive or neutral force in economic (and subsequently social) modernization whereas the Soviet military has been a relatively hostile force. China has experienced no analogue of the U.S.S.R.'s high level military denunciations of reform or the abortive 1991 coup against Gorbachev. Since the low budgets and limited missions of the Chinese military are very much in the interest of regional peace and arms control, and since PLA support of the economic reforms is critical to the chances for improving the livelihood of a fifth of the human race, one wants always to maintain the future prospect that good behavior will lead to access to a broad range of technologies. In short, one wants to employ sticks and carrots that improve China's adherence to the "system," not expel China from it.

Multilateral Aid. As a sanction against Chinese human rights practices, the U.S. seeks to limit aid to China by international financial institutions such as the IMF and World Bank. It supports aid for basic human needs but opposes aid for economic reform. This policy is the ultimate example of the contradiction between the political need for an easy symbol of protest (aid can be cut instantly and without damaging domestic economic interests) and the necessity to promote economic liberalization and prosperity in order to evolve the kind of educated, pluralistic, middle class society in which human rights would flourish. U.S. allies have decided to focus on the longer term, leaving the U.S. isolated in its obsession with short-term political symbols.

Hong Kong's COCOM Status. A seeming technicality in the COCOM rules has long held Hong Kong's fate in the balance. Hong Kong is a regional services and banking center and as such is utterly dependent on high technology. For instance, Hong Kong's banks employ some of the most advanced computer systems; these are typically changed roughly once

every four years, so Hong Kong would begin to fade as a regional center in about four years if it were denied access to such technology. As an outpost of Britain, it has always had such access. On the other hand, Hong Kong is China's window on the world of modern technology, and Hong Kong will revert to Chinese sovereignty in July 1997. If it is considered part of the Chinese economy, then it is subject to COCOM restrictions that would ban the technologies the banks, accounting firms, engineering firms, and many others require. Facing this dilemma, the U.S. has investigated the tightness of Hong Kong's border controls on the flow of technology and COCOM is about to certify Hong Kong as having adequate controls and therefore eligible to import sensitive technologies (technically, 5-K status, the same as members of COCOM).

The Broad Rules of Fair Trade. More broadly, Chinese trade and intellectual property practices pose a problem for the U.S., structurally typical of the U.S. problem with other Asian states and proportionately of a similar order of magnitude. Since roughly similar problems have been resolved with other Asian countries, they are in principle solvable with China also. But the U.S.-Chinese dispute is complicated by four factors.

First, the U.S. deliberately went easy on, for instance Thailand, because it was an ally, whereas it is inclined to push harder on China because China is not an ally.

Second, with Japan and the smaller Asian states the trade negotiations were really about trade, whereas with China they are really about human rights. While the USTR is genuinely concerned about trade practices, and there is genuine concern in economic circles about China's huge surplus with the U.S., the driving force behind the trade negotiations is Congressional desire to "get" China for human rights abuses. This means that Chinese concessions are discounted or sometimes even ignored.

Third, the Chinese government is fragile, and therefore hypersensitive to U.S. political motives in the trade negotiations; the converse of U.S. use of trade as a stick to promote human rights is that China sees every trade dispute as an attack on its political system and a potential infringement of its sovereignty. China alleges, with considerable justification, that no set of trade concessions will conciliate a Congress that is really trying to force changes in human rights and therefore offering concessions may simply increase demands by showing that China is vulnerable to pressure. This leads Chinese spokesmen to characterize every issue as one of sovereignty, and adopt a face of intransigence, even when China is actually offering major concessions.

Fourth, although ideological differences are in most cases more noise than reality, there are additional complexities in adjusting a full-blown socialist system to capitalist trade practices. For instance, under China's socialism the whole concept of intellectual property rights was unintelligible; the state owned all such things and there was no need for detailed laws specifying rights. China initially offered to adopt a set of international laws specifying property rights, and to state that the international obligations override the domestic ones when there is a conflict in a specific case, but the U.S. insisted that China's domestic laws

as well as its international agreements must meet U.S. criteria. More broadly, during the transition period China becomes vulnerable to a kind of trade policy Catch-22: it is prosecuted both for the characteristic problems of trade with a socialist system, such as export subsidies that compensate for an overvalued exchange rate, while simultaneously being prosecuted in some cases as a market economy--most notably in a recent dispute over ceiling fans.

The U.S. is pushing China harder and faster than it pushed Taiwan, South Korea, and ASEAN countries. It is insisting that China solve intellectual property issues in a year that Thailand, Indonesia, Singapore, and Malaysia, proportionately much worse offenders,¹³ have refused to resolve for many years. China takes this to be unfair and unreasonable. In China's eyes, America is disguising a political dispute as a trade dispute and is bringing unfair trade pressure in order to undermine China's political system. It is true that the U.S. is treating China particularly harshly for political reasons. On the other hand, America's toleration of huge trade surpluses on the part of Asian allies, sustained by their unfair trade practices over a generation or more, cannot be regarded as a "normal" phenomenon. It was in fact an aberration that occurred because (1) for a limited period of time the U.S. economy was so strong that it seemed capable of sustaining such deficits; (2) national security issues overrode short-term economic considerations; and (3) the countries running the big surpluses were regarded as important allies of the United States. In the trade dispute with China, the U.S. economy is weaker, national security issues are less immediate, and since June 1989 the Chinese government has appeared to Washington as an offender against profoundly important American values rather than as an ally or close colleague. In short, American tolerance of past Asian trade practices was a politically-driven decision just as American intolerance of similar Chinese trade practices is today a politically-driven decision.

Within this broader perspective of pushing China much harder than other countries, there is a fundamental division between the Congressional and Presidential approaches. The majority of Congress wants to have a giant confrontation over MFN that would set a deadline of six months to a year for complete Chinese capitulation on all the most important human rights, trade, and strategic issues. In contrast, the Bush administration seeks to channel this Congressional fervor into a series of less cataclysmic and more focused negotiations to achieve specific reforms. The executive branch is separating strategic, human rights, and economic issues. On the economic issues, it is focusing attention on intellectual property issues and trade fairness issues. And in the economic negotiations it is making its complaints selectively so that China's acquiescence would make it eligible for GATT. This is why U.S. complaints focused on export subsidies, import restrictions, non-

¹³U.S. diplomats estimate that pirated software comprises 90 percent of all software used in Taiwan and Singapore and 70 percent in Hong Kong, and that 90 percent of all pirated software in Southeast Asia is produced in Singapore, where tight government controls on the economy make control of such activities extremely easy for the government to implement. This has been happening for many years without even the suggestion of drastic sanctions like those being proposed for proportionately infinitesimal infractions in China.

discrimination, and transparency of trade regulations. Membership in GATT would confer a wide range of benefits on China, including automatic benefits from many countries other than the United States as well as going a long way toward terminating the controversy over most favored nation status in the U.S. (The U.S. could issue an exception and deny China MFN status even if it was a member of GATT, but this would set a very bad precedent.)

Intellectual Property. China has followed countries like South Korea, Taiwan, Thailand, Malaysia, and Indonesia in taking full advantage of Western products without paying the companies that own them. Chinese concerns duplicate U.S. computer software on a very large scale without paying royalties, infringe trademarks, copy and distribute chemicals and pharmaceuticals without paying for them, exploit access to U.S. companies' trade secrets, and copy and export legally protected hardware of many kinds, in some cases nearly driving small U.S. firms into bankruptcy. China awards trademarks to the first applicant regardless of the original owner. Because of these complaints, on May 26, 1991, the U.S. Trade Representative designated China for investigation under the Special 301 provisions of the 1988 Trade Act and, following unsuccessful negotiations, listed items for potential retaliation in the **Federal Register** on December 2, 1991.¹⁴

At the same time, China has moved very fast toward acceptance of Western capitalist principles. The concept of intellectual property is new for China, and incorporating Western capitalist concepts of ownership into Chinese socialist law is a complex process. The vast majority of capitalist third world countries take the position that patents on pharmaceuticals, and the resulting high prices for drugs, are not acceptable, and even a close ally like Thailand has refused for many years to protect computer software. China had previously accepted the concept of intellectual property and applied for membership in the Berne Convention. Arpad Bogsch, Director General of the United Nations World Intellectual Property Organization, noted that only 100 countries even have patent laws and that of these 50 are similar to China in not protecting chemicals and pharmaceuticals.¹⁵ After cutting through the rhetoric, China had gone further than much of the third world in accepting U.S. principles but was having difficulty adjusting its system and moreover was asserting a right to the same kinds of delays in implementation that most non-communist Asian countries had long enjoyed. The U.S. was implicitly saying that China will be held to much higher standards than others at comparable levels of development and that China had no political basis for the special treatment hitherto given to allies. Moreover, the USTR deliberately chose to use China to set a high-profile precedent for negotiations with other third world countries, such as India, which have hitherto objected in principle to these U.S. demands.

¹⁴Cf. pp. 61278-61283 for the details of proposed retaliation.

¹⁵See Kennis Chu, "China Demands Fair Play Over Property Rights," **South China Morning Post**, 1 December 1991

After a series of confrontations which seemed to lead to the verge of trade war, Beijing and Washington agreed on January 17 to sign a Memorandum of Understanding that terminated the USTR's investigation and threats regarding intellectual property.

China agreed to very broad, modern protection of copyrights, patents, and trade secrets. On copyrights, it committed to join the Berne Convention, to join the Geneva Phonograms Convention, to protect computer software as literary works, to enforce copyright owners' right to control rental of their works, to give these international standards precedence over existing domestic law, to bring its domestic laws into consistency with the agreement, and to inform the U.S. of internal guidance related to the agreement. On patents, China will make best efforts to amend its patent law before January 1, 1993, to make pharmaceuticals and agricultural chemicals (in addition to their production processes) patentable, to expand protection of production processes for these items, to protect patented items for 20 years, and to limit compulsory licensing of patents. China agreed to make best efforts to pass implementing legislation to protect trade secrets by January 1, 1994. Trademarks were not addressed by the agreement because China already had a revised law scheduled for enactment in the latter half of 1992.

What China agreed to makes it in principle one of the leaders in the third world in accepting the West's version of intellectual property. That China was willing to abandon positions endorsed by at least half of the third world testifies to its flexibility, reformist momentum, and determination to entrench itself as a major member of the world trading and investing community. At the same time, further difficulties over implementation are unavoidable. The degree of sincerity with which Beijing signed the agreements remains to be tested. Many of the clauses in the agreement specify that Beijing will make "best efforts," a phrase that creates considerable room for fudging. Moreover, Beijing's writ is weak along the coast where these issues arise, and local businessmen abetted by wily Hong Kong and Taiwan businessmen will undoubtedly elude regulation for many years.

Market Access. China has used import licenses and high tariffs to discourage very broad categories of imports. It traditionally subsidized its exporting firms although on January 1, 1991, it announced that such subsidies had been abolished. The government frequently instructs its firms as to whom they should deal with, and regulates trade and investment by means of internal regulations that are not published and thus confuse and waste the efforts of U.S. firms, as well as exposing them to arbitrary or corrupt interpretations of these rules. In response, the USTR launched a one-year investigation on October 10, 1991.

Here again China has been conducting itself in a manner similar to countries whose practices were until recently tolerated by the U.S. for three decades or more. On the one hand, China's actual practices, which are at a level similar to those of South Korea two decades ago, are utterly unacceptable in principle to the capitalist world. On the other hand, what it does is fairly standard third world practice and the pace of liberalization in China has no peers. Particularly noteworthy are its move to a near-market exchange rate, its abolition of most export subsidies, its announced willingness to abolish most import

licenses, and its announced willingness to make most (but not all) trade and investment regulations transparent and not apply the secret rules to foreign transactions. In September and November 1991, China announced tariff reductions and promised to bring tariff regulations in line with international practices.

With an eye on Congressional antipathy for China, and another eye on the \$10 billion U.S. trade deficit with China, U.S. negotiators have chosen to focus on China's abuses as compared with first world countries rather than on the rate of reform. Again they are demanding much more from China than from others. The USTR's investigation of China is legally scheduled to culminate in October 1991, but the Bush administration is pushing for conclusion by summer in order to avoid juxtaposing the trade negotiation with the November U.S. elections.

China's \$10 billion surplus is a key focus of Congressional attention. The U.S. calculates the surplus and bases policy on its own calculation. China on the other hand calculates a deficit with the U.S. The difference arises from the fact that China counts exports to Hong Kong simply as exports to Hong Kong, whereas the U.S. counts goods as Chinese exports to the U.S. if they are predominantly made in China then exported to Hong Kong and re-exported to the U.S. In an accounting sense, the U.S. is correct. On the other hand, China is a victim of a situation where Hong Kong and Taiwan have essentially exported their surpluses across the border, while retaining ownership, management control, and most of the profits and leaving China to take the heat from Washington. For instance, most of the Taiwan shoe industry has relocated to the mainland--a great benefit both to Taiwan's profits and to the schedules of Taiwan's trade negotiators. At a time when products may move across half a dozen international borders before being exported to their ultimate market, the concept of the country of origin has become a very flexible tool of nimble companies based primarily in Japan, Taiwan, Hong Kong, and Singapore. There is as yet no satisfactory substitute for this concept, and as a practical matter China is stuck with the policy consequences, but one cannot understand the psychology of the Chinese side of the negotiations without appreciating the extent to which the PRC is being exploited as an export platform by its investing neighbors. (Conversely, revelations of the degree to which Chinese-origin goods are being mis-labelled by Chinese, Hong Kong, and Taiwanese firms have just begun and will provide U.S. Customs with many years of gainful employment.)

Another complexity in the great trade deficit dispute resembles the old model of an arms race where each party builds up arms in an unending spiral of response to the other party. After Tiananmen Square, much of the world, and especially the U.S., effectively declared financial war on China, terminating many kinds of loans in order to punish the leaders of the regime that perpetrated the tragedy. Facing this and a serious domestic inflation, China pursued an austerity policy and an effort to build up foreign exchange reserves to combat the danger. The U.S. then condemned China's efforts to build up reserves as unfair trade policy. In the second round of this "arms race," all other significant trading countries reverted to normal trade and financial practices, including concessional loans, whereas the U.S. did not. The U.S. still prohibits OPIC insurance and Export-Import Bank loans for

China and is trying to limit IMF and World Bank loans for China. This puts U.S. firms at a severe disadvantage, since financial packages are frequently the deciding factor in major infrastructure contracts.

U.S. technology sanctions in response to strategic disputes had the same effect, potentially disabling Boeing in competition with Airbus. This substantially increases the U.S. deficit, and the U.S. responds by further confrontations with China.

Despite these problems with U.S. policy, China's position is weak because it has engaged in such a wide range of clearly unfair practices. If the market access negotiations are as successful as the intellectual property negotiations, these Gordian knots will be cut. In the meantime, the two countries will likely come once again to the brink of trade war.

Transitional Issues: GATT, Jackson-Vanik, Aid. The U.S. has been generally supportive of China's efforts to participate in international trade organizations and, for instance, encouraged simultaneous PRC and Taiwan membership in APEC, the regional economic consultative organization. China, at one time a member of GATT (General Agreement on Tariffs and Trade), seeks reentry, and Taiwan also seeks entry, but China insists that it be allowed to reenter before Taiwan's membership is accepted. The U.S. has encouraged China's aspirations to participation in GATT, but insists, reasonably enough, that China first comply with the basic requirements of membership. China's present restrictive trade policies clearly do not comply. As noted above, the U.S. has structured its trade negotiations so as to press China in the direction of compliance. Although the policy has not been authoritatively published, the U.S. generally favors the APEC formula of simultaneous admission of both the PRC and Taiwan to GATT at the time when China's policies come to satisfy GATT requirements.

GATT membership is just one of the issues that will arise as China moves rapidly toward a market economy. Under U.S. law, market economies are treated differently in many ways from non-market economies. When China becomes a market economy, the immigration requirements of Jackson-Vanik, which were designed originally to force the Soviet Union to allow free emigration of Soviet Jews, will no longer apply. On the other side of the coin, the legal requirements applied to trade are much higher for products in a market economy; already there is a major legal case arguing that Chinese-exported ceiling fans are produced in a market environment and therefore must satisfy the higher requirements. Unless the U.S. administration delineates a clear boundary, the transition could become a political football and a legal nightmare.

Finally, there is the issue of potential U.S. aid for China. Currently, it is politically incorrect even to raise this as an issue; after all, U.S. policy is to discourage others, including multilateral institutions, from giving aid. But it is very likely that the time will come when the American people tire of promoting billions of dollars of aid (their own and Europeans') in support of hopeless economic policies in the former Soviet Union and realize that China is the one former socialist country with an economic policy so successful that aid would be

very efficiently used. Possibly a political transition in China will coincide with disillusionment over the failure of the Gorbachev/Yeltsin approach to economic reform, and this will prepare the ground for resumption of U.S. aid to China.

Overview

On balance, then, all aspects of the trade dispute are based on legitimate U.S. economic grievances against China. But the timing, pace, intensity, and tone with which these grievances are pursued derive from Congressional desire to punish China for human rights abuses.

Since human rights policy is the driving force behind U.S. economic policy toward China, it is appropriate to conclude with reflections on the larger relationship between human rights and economic policy.

The syllogism of the Congressional drive for economic sanctions against China is as follows. The massacre at Tiananmen Square was evil, and the current leaders' abuses of human rights are unacceptable. The non-economic sanctions that are available are inappropriate; military action is too dangerous and expensive, and political tools such as Voice of America broadcasts are too weak. Therefore economic tools should be used, and the more powerful the economic tool the better.

The problem with this syllogism is that it ignores the dynamics of how politics, economic growth, and social structure interact inside China. The first order problem is that Congress wants to punish Li Peng for Tiananmen Square, but chooses a tool (MFN deprivation) that primarily hits Hong Kong, secondarily damages the more liberal coastal leaderships that represent China's brightest hope for a more relaxed and prosperous future, and may actually support even harder-line factions Li Peng's. In short, the syllogism is broken by the dynamics of China's domestic leadership struggle.

The second order problem is that the economic sanctions target a Chinese economic reform that is delivering a better life for most of the Chinese people, who constitute a fifth of the human race. It is delivering the economic improvements at a rate which 50 years ago was thought impossible for any country and 10 years ago was thought impossible for any country except Japan and a few very small populations on the Pacific Asian periphery. A few years of growth at this rate make the difference between sub-human subsistence and modern life (not having to worry about starvation anymore, having decent modern clothing for the first time, getting access to plumbing for the first time). It is impossible to square any sanctions such as MFN deprivation that would endanger this economic takeoff with human rights advocates' declaration of profound concern for the Chinese people.

Third, we know from the model of South Korean development, which the Chinese leaders are attempting to follow, that this process of rapid economic development, rapid social

differentiation, and increasing exposure to the outside world leads inexorably to pressures for greater freedom and for political relaxation. We know from watching both Taiwan and South Korea that these pressures eventually (over a generation or two) become so strong that they cannot be resisted. The economic liberalization has decentralized power and to an extent that has given rise to highly autonomous coastal developments that have severely curtailed the power of the orthodox communist leadership in Beijing. Moreover, the process of economic development has created a more pluralist society (not a pluralist society in any absolute sense, but an increasingly pluralist society) that is increasing the population's access to different ideas, its freedom to move, its freedom to express opinions, and its ability to criticize and pressure the leadership. Once the population is no longer in the thrall of a totalitarian ideology, the process of social differentiation gradually disengages the levers by which a Park Chung Hee or a Chiang Kai Shek or a Li Peng can control the population.

What the Congressional pressure for a total confrontation with China on trade (by deprivation of MFN or by demanding faster progress than the system may be able to sustain) does is to put this process at risk. The desire for revenge against Li Peng unconsciously is allowed to threaten a process that is liberating a fifth of the human race--initially by ending the desperate impoverishment that has given rise to China's despair and radicalism, later by social relaxation and gradual development of political pluralism. It is a questionable human rights policy that focuses exclusively on the leadership and threatens the entire Chinese population with loss of the economic and political fruits of rapid development.

One of the tests of a human rights policy is that it should align Washington with the next generation, especially with those of the next generation who represent the strongest forces for improvement. By this standard, the economic confrontation runs a great risk. If it were to be successful at threatening the Chinese leadership into considerable political relaxation without damaging the Chinese economic takeoff, it would pass this test. However, this writer knows of no close student of China's leaders who believes they will succumb to this kind of frontal attack. And if the economic confrontation leads to a collapse of trade and a crashing of the Chinese economic takeoff, even the student refugee factions who are now loudly demanding MFN termination will become ardent enemies of the country that caused the collapse. Congressional advocates of MFN deprivation argue that they don't want to take away MFN but just to threaten in order to obtain human rights leverage. However, it is very risky to draw a pistol on the assumption that one will never have to fire it.

It is not an effective riposte to argue that economic liberalization can only continue to be successful if it is immediately linked to political liberalization. This argument is extremely popular in the West, but it is refuted by the whole third world's experience of development. We applaud the Cory Aquino/Mikhail Gorbachev/Raul Alfonsin/Shagari approach of instant democratization followed by economic reform. We devote billions of dollars of subsidies to those who follow this model, and are always surprised when such leaders cannot reform the bureaucracies, liberalize the prices, open the trade, and take the other desperately needed painful decisions. Nobody should understand the difficulties of this

strategy better than American Senators and Representatives who are afraid to push their constituents toward a balanced government budget. This path maximizes the influence of powerful pressure groups just when government is weakest and when the need for excruciatingly painful reform decisions is greatest. Therefore this path leads to economic decline, political collapse, and renewed authoritarianism. The only cases in the third world of sustained rapid growth, sustained progress toward social pluralism, and permanent shifts toward prosperous democracy are those like South Korea, Taiwan, Thailand, and Singapore which have taken the painful reform decisions under relatively authoritarian leadership, generated rapid growth, allowed the growth time to evolve a pluralist society, and built democracy upon the resultant pluralism.

China is embarked on this process. It is suffering much of the same excess of authoritarianism, ideological foolishness, and gratuitous violence that other Asian societies have suffered as they sought a path to rapid development. It is no coincidence that the press reports and liberal Congressional speeches about China in 1991 are almost identical to those about South Korea in 1976. They focus on leaders and ignore what is happening to the lives of ordinary people. They focus on a few dramatic political events and ignore economics. They focus on today and ignore the long-run trends. They do so with a rhetoric that can only be called demonization.

The Congressional priority for human rights is entirely appropriate. U.S. pressures for amelioration of unfair trade restrictions are essential to serve U.S. interests and will eventually serve China's interests too. Recognition of links between economic policy and human rights is unavoidable. But the debate between the geopolitical and human rights factions is not really about human rights, because the policy advocated by the Congressional human rights faction will not in fact promote human rights; it will only dramatize human rights frustrations at great human cost.

The proper policy to promote sustainable human rights is to give first priority to opening and reforming the Chinese economy so that China's society will continue to become more pluralistic and more free. Such a policy will also ensure that China continues to understand and enjoy the benefits of subordinating military power and geopolitical competition to rapid economic development. In the short term, human rights abuses can be ameliorated by publicly confronting China's leaders (as occurred on every stop of Li Peng's diplomatic tour in January 1992), by publicizing human rights abuses widely, by visiting dissidents and broadcasting to them in order to bolster their courage, and by using every meeting to extract concessions. Such a policy worked in South Korea and Taiwan, and it can be equally effective in China. Properly sequenced and modulated, the U.S. can ameliorate human rights abuses in the short run, hasten Chinese economic reform, maximize U.S. benefits in trade with China, enhance Chinese progress toward prosperity and pluralism, and strengthen the U.S. geopolitical position as a result of the gratitude of the next generation of Chinese for U.S. contributions toward these goals.

Such a policy will also create a context that maximizes the prospects for the success of the intellectual property negotiations to be followed by similar success regarding market access.

Alternatively, the U.S. can demonize China, create a cataclysmic economic confrontation, interrupt an economic takeoff that has improved the lives and captured the imagination of a fifth of the human race, and earn the long-term enmity of a nation that seems to be finding its feet for the first time in two generations despite the foibles of its leaders.

There is a further geopolitical danger in this latter scenario. Usually in American history, when we have demonized Japan we have regarded China as an angel, as with Chiang Kai-Shek in the 1930s and 1940s. Conversely, when we have demonized China we have regarded Japan as an angel, as in the 1950s and 1960s. Today the same political forces that are demonizing China are inclined to demonize Japan also. For the past decade these two economies have been the two most dynamic large economies in the world, and their dynamism, combined with the collapse of the Soviet Union, ensures that they will play an ever-more-potent role in whatever world balances come to characterize the post-Cold War order. This is comparable to confronting Russia and Germany simultaneously in the 1970s. Today there is a euphoria as if the end of the Cold War means that history has indeed ended. Those who are skeptical that history has ended may wish to reflect deeply on a path that leads to simultaneous demonization of the world's two most dynamic powers.